

PROVIDING ALTERNATIVES TO PAYDAY LOANS

North Side Community Federal Credit Union is a \$9 million 29 year-old community development credit union with a history of serving people who are not using mainstream financial institutions. We are certified as a Community Development Financial Institution (CDFI) by the US Treasury, and have a low-income service designation from NCUA. Our niche is serving the “unbanked,” low- and moderate-income people who are in need of financial literacy and budgeting help, in addition to low-cost checking and savings accounts. We provide our 3,800 members with an alternative to the payday and predatory lenders who take advantage of low-income people.

Over the past 3 years, we have become increasingly frustrated with the number of people coming to North Side trying to pay off expensive payday loans. In April of 2002, we made our first loan under a new initiative to provide an alternative to these predatory lenders that have mushroomed in our community over the past decade. Our Payday Alternative Loan (PAL) is a \$500, six-month loan which is made at 16.5% APR. With the support of The Northern Trust (which provided \$20,000 for a segregated loan loss reserve), PAL builds on the success of our Hot Funds/Cold Cash small loan program which has disbursed over \$1,000,000 in 2,000 loans over the past nine years. While Hot Funds/Cold Cash required a one-year membership in North Side for approval, PAL is approved automatically and funded immediately for any community resident who has an income of \$1,000/month, regardless of credit history. We structure repayment from payroll deduction when possible, which is more convenient for the borrower and decreases our delinquency and losses.

How has the product performed? We have made 1,523 PAL loans to date, with 866 being paid off and fourteen write-offs. Of the 643 currently in the portfolio, the delinquencies are as follows: 15 day: 21%, 30 day: 19%, 60 day: 13%, and 90 day: 11%. These delinquencies have risen slightly over the past four months, and are obviously well above the delinquency rates in our other product lines.

We are concerned that over one-half of the 643 existing loans are to repeat borrowers, many of whom have taken out second PAL loans prior to completely paying off their first loan. For repeat borrowers, we will lend the balance of principal that has been paid, so the maximum outstanding loan cannot exceed \$500. We also now limit members to 2 loans per year, and

the second loan cannot be funded until the first loan has been paid down to a balance of \$250 or less. As a result of the requests for repeat loans, in March of 2003 we added an optional financial literacy component, with borrowers who complete the program receiving a financial incentive when their loan is paid off on time, and additional incentives if deposits are made to build up a savings account to \$500 after loan payoff. We have made the financial literacy component optional because we do not want to “cream” and serve only the most motivated borrowers with our program.

We do know that we are hitting our target market. Although we don’t use credit reports for the loan approval, we are running reports for statistical and research purposes. As the following FICO scores show, the loans are being utilized by people with very poor credit who have few other options for emergency needs.

PAYDAY ALTERNATIVE LOAN CREDIT SCORES

Over 700	-	1%	Average score	- 548
600-699	-	13%	Bankruptcy c/in last 3 years	- 10%
500-599	-	56%	Average # of collection accts	- 5
Under 500	-	16%		
No score	-	14%		

We are also asking the purpose for the loan with this product, and the results show the typical reasons for emergency borrowing in low-income neighborhoods. Utility bills, auto expenses (repair, insurance, tickets and booting), child care, rent, medical bills and paying off other payday loans are all common uses of the loan proceeds.

Our experience shows how difficult it is to offer affordable small consumer loans in a self-sustaining program. No matter what “reasonable” interest rate is charged on a \$500 loan, little interest income is generated to offset the transaction cost of the loan. Rather than viewed on a product basis, “profitability” must be viewed on a long-term relationship basis with the member. Toward this end, we have received support from the National Credit Union Foundation’s Callahan Fund to graduate PAL borrowers to larger loans and other asset-building products, expand the financial literacy program, and increase our market share in the small consumer market in a sustainable manner.

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